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SUBJECT: SURPRISES IN EGYPT'S BANKING SECTOR

Summary

11. (SBU) In a surprise move earlier this week, the GOE announced the merger of two of Egypt's state-owned banks, Banque du Caire and Banque Misr. The GOE also announced that the banks' management would be changed in anticipation of the merger. The banking sector reacted positively to the news; through some local contacts believe the move may be merely a delaying tactic to stall resolution of the public banks' non-performing loan (NPL) portfolios. Banque Misr also recently sold its shares in Misr International Bank (MIBank), which were purchased by National Societe General Bank (NSGB). MIBank employees resigned en masse in anticipation of changes to their compensation package. It is not yet clear if the mass resignation will affect future acquisitions, but for the time being, foreign banks still appear to be positioning themselves in the Egyptian market. The GOE plans to use proceeds from the sale of shares in Joint Venture (JV) banks to re-capitalize the state-owned banks. End summary.

... and Then There Were Three

12. (U) In a surprise move on September 25, the GOE announced plans to merge the second and third largest state-owned banks, Banque Misr and Banque du Caire. The CBE issued a statement indicating that the merger was another step in its plan to consolidate the banking sector by creating fewer and stronger banks. Banque Misr, the second largest state bank, had assets of LE 91 billion at the end of FY 2003/04 and a 17% market share. Banque du Caire had assets of LE 45 billion at the end of FY 2003/04 and a 6-7% market share. After merger, the new entity will be almost as large as the leading state-owned bank, National Bank of Egypt (NBE). The new bank will have assets of approximately LE 130 billion (USD 22 billion) and 23-24% of the market. NBE had assets of LE 131 billion at the end of FY2003/04.

Shuffleboard

13. (U) Coinciding with announcement of the merger, the Prime Minister's office also announced a reshuffling of the boards of directors of the state-owned commercial banks as well as the Industrial Development Bank and the Egyptian-Arab Real Estate Finance Bank. According to the Cabinet press release, the Board of Banque Misr, headed by Mr. Mohamed Barakat, will manage Banque du Caire for the next six months to prepare for the merger. Ahmed El Bardei, the Chairman of the troubled Banque du Caire, was dismissed in the reshuffle. Banking sector contacts had long predicted a reshuffling, but most anticipated Barakat would be made chairman of NBE. An initial meeting has been fixed for October 3, for the shareholders' general assemblies of both banks to discuss the merger.

Bank Sector Reacts Positively

14. (SBU) Reaction to the announcement was generally positive. Most banking contacts saw the merger as a sign of CBE's continued commitment to rapid consolidation of the banking sector. Some local bankers, however, questioned the motivation for the move. Michel Accad, Chairman of Citibank, said the merger gave the appearance of consolidation, but was really intended to buy time before making a decision on resolution of the NPL portfolios of the state-owned banks. The "Big Four" banks hold around 90% of the debts of Egypt's state-owned enterprises. Although actual figures for the NPL ratio in the state banks are not publicly disclosed, most estimates place it at 20-30% of total credit portfolios.

Banque Misr Divests Shares in MIBank

15. (U) In early September Banque Misr sold its 25.5% share in MIBank to NSGB. The Capital Market Authority had announced that whomever won Banque Misr's 25.5% could then bid for 100% of MIBank. NSGB later completed an acquisition of MIBank on September 15, with a purchase of 90.7% of shares for LE 1.694 billion at LE 43.20 per share. A merger of the two banks, which will be completed in a few months, will follow the acquisition.

16. (U) Completion of the acquisition was delayed a number of times, however, by the resignation of much of the bank's staff due to differences in salary scales, remuneration packages and other benefits between MIBank and NSGB, with MIBank's compensation being much higher. The major problem, which generated mass resignations (approximately 250) at MIBank, was an anticipated change to the MIBank employee insurance fund, in which employees were entitled to between LE 70,000 and 1.25 million each in severance pay plus pensions, and family-member medical insurance. It was rumored that NSGB intended to liquidate the employee fund. Mohamed Antably, Head of Correspondence Banking at NSGB, stated it in a different way: according to NSGB's bid, the employee fund at MIBank was to be maintained up to the date of a merger.

Prospects for future privatization

17. (SBU) Antably's spin did nothing to prevent the mass resignation, which according to some local business contacts has cast a pall over future prospects for bank privatizations. Hamed Fahmy, Managing Director of Allied Corporation Egypt told econoff at a dinner of the U.S.-Egypt Business Council that he feared the MIBank employee exodus might scare off prospective buyers, who would be hesitant to enter the market due to potential labor difficulties. Other contacts in the banking sector are more sanguine, however, about future prospects for bank privatization. Roderick Richards, Managing Director of Egyptian American Bank (EAB) told econoff that EAB had received 15 bids in response to its recent offering memo. Most of the bids were from foreign banks looking to either enter Egypt's market or expand their current operations.

Re-capitalization

18. (U) The GOE plans to use proceeds from the divestiture of state shares in JV banks such as MIBank to cover some of the cost of the re-capitalization of the state-owned banks. The Ministry of Finance has also reached an agreement with the state-owned banks whereby it will issue 20-year bonds, with a 10% coupon, to repay the LE 18 billion in overdue debts of public sector companies to state-owned banks. While the combined proceeds from JV divestiture and a bond issuance will cover a large percentage of the state-owned banks' NPL portfolios, it will not solve the problem completely. The GOE will still have to decide on a policy for resolution of privately held debts to the state-owned banks. In particular, the credit portfolio of Banque du Caire includes the NPLs of two well-known Egyptian tycoons - Rami Lakah and Hatem El Hawari, whose debts reach approximately LE 1.7 and LE 2 billion, respectively.

Comment

19. (SBU) The Governor of the CBE indicated that decisions for additional privatization of state-owned banks would await an evaluation of the privatization of Bank of Alexandria (BA). BA's privatization is on track for completion by the first quarter of 2006 at the latest. The process has been quite lengthy, however, and continues to face some opposition from voices claiming that privatization of ownership is not necessary as long as state-owned banks are managed like private sector banks. In any event, the GOE decision to merge Banque du Caire with Banque Misr appears to reflect a realistic assessment of the possibility of finding a buyer for Banque du Caire. Given the bank's poor condition and weak balance sheet, CBE most likely decided that merging it with a large, better managed bank was the best way to continue consolidating the banking sector without going through the lengthy, and costly, process of privatization. End comment.